ANNUAL REPORT FOR 1971

MESA PETROLEUM CO.

MESA
PETROLEUM CO.

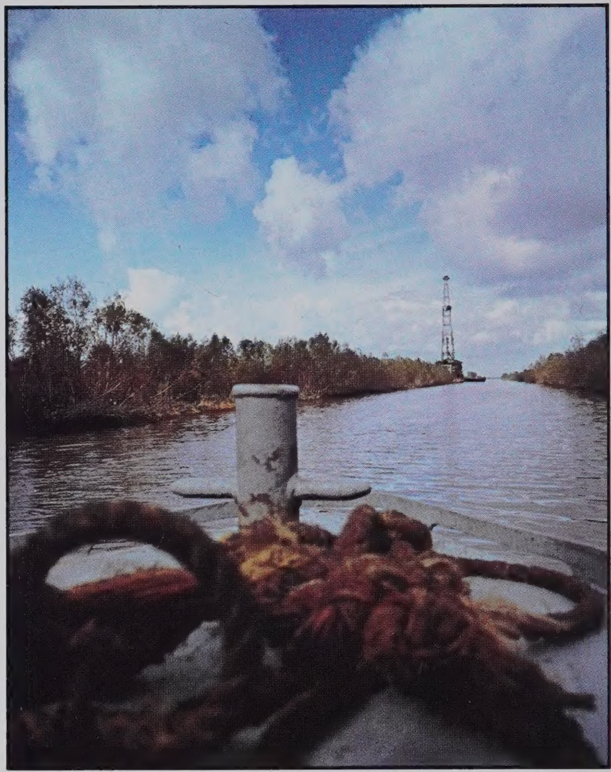
CONTENTS

The Annual Meeting of the Stockholders of Mesa Petroleum Co. will be held at the auditorium (lower level) of the First City East Building, Houston, Texas, at 10:00 A.M. on April 26, 1972.

Development drilling from platform "A" on East Cameron Block 270.

Highlights

1971
ANNUAL
REPORT



Crewboat cruises toward a drilling rig in southern Louisiana

	1971	1970	1969	1968	1967
FINANCIAL					
Revenues	$ 88,094,000	$47,362,000	$26,957,000	$16,404,000	$16,214,000
Cash flow, excluding extraordinary items	$ 19,747,000	$ 9,443,000	$ 9,487,000	$ 7,066,000	$ 6,555,000
Income before extraordinary items	$ 12,721,000	$ 6,939,000	$ 8,257,000	$ 6,034,000	$ 5,521,000
Net income	$ 12,721,000	$ 6,685,000	$ 8,531,000	$ 6,220,000	$ 5,841,000
Earnings per common and common equivalent share before extraordinary items	$3.05	$1.76	$2.14	$1.56	$1.40
Total assets	$104,691,000	$83,216,000	$78,236,000	$34,231,000	$29,701,000
Stockholders' investment	$ 49,959,000	$32,915,000	$27,806,000	$15,540,000	$21,462,000
OPERATING					
Net production (after royalty)					
Oil and condensate (bbls.)	414,199	390,634	337,449	353,561	328,767
Natural gas liquids (bbls.)	1,319,519	688,041	688,932	701,576	605,702
Natural gas (Mcf.)	73,466,290	45,846,289	42,557,177	39,580,690	40,305,312
Non-producing acreage					
Gross acres	3,640,432	4,229,513	4,058,725	3,456,688	1,955,253
Net acres	2,281,824	2,118,941	2,237,325	1,783,314	838,618

To Our Shareholders

Dear Shareholder:

The year 1971 was one of particular significance to Mesa Petroleum Co. As reflected by the highlights on the preceding page, record results were obtained in both our petroleum and cattle operations, and important steps were taken to perpetuate future growth. Mesa initiated its first major effort offshore by participating in exploratory and development work on five tracts in the western Louisiana Federal offshore area. Significant reserves have been established on two of these tracts, and initial production should begin during the fourth quarter of 1972. In February, 1972, less than one year from the inception of exploratory drilling, Mesa executed a very favorable twenty-one year Gas Purchase Contract with United Gas Pipe Line Company covering gas produced from Mesa's interest in the five offshore tracts.

A large portion of our capital expenditure during 1971 was devoted to exploration in the Gulf Coast and in Canada. Major steps were also taken to extend our exploration activities into selected foreign areas. In September, Mesa and several partners filed applications on twenty-two tracts in the United Kingdom sector of the North Sea. We expect the British Department of Trade and Industry to announce the successful applicants for these tracts during the first half of 1972. In November, we announced an agreement under which Mesa can earn a 75 per cent interest in approximately 500,000 acres in the Tassi-Marin concession on the offshore continental shelf of Gabon in Central West Africa.

Results of Operations

Gross revenues and net earnings reached all-time highs during 1971. Revenues for the year increased to $88,094,000 from $47,362,000 for the comparable period in 1970. Per share earnings on a fully-diluted basis and excluding extraordinary items increased 73 per cent to $3.05 per share, compared to $1.76 for 1970. The substantial gain in both revenues and net income is due primarily to record increases in the production and sales of natural gas, natural gas liquids, and oil, and a significant contribution from our Agro Division. In the financial section of this report, the consolidated statement of income, for the first time, reflects separately the results of both our oil and gas and agribusiness operations.

Personnel

Mesa continued to add to its technical staff during 1971. We now have sixteen geologists, six landmen, five geophysicists, and eight engineers. These people are located in three offices; the Executive offices and Central Division office in Amarillo, the Canadian Division office in Calgary, and the Gulf Coast Division office in Houston. In January, 1972, the Rocky Mountain Division and the Mid-Continent Division were consolidated into the new Central Division. Mesa's philosophy is to employ a small group of well-trained, highly motivated people organized into two levels of management. This method results in a more systematic flow of information to upper management, and quicker, more objective decision making.

Exploration and Development

During 1971, exploratory emphasis was placed on acreage in Canada and the Gulf Coast areas of Louisiana and Texas. In Canada, exploratory work was centered in Alberta and British Columbia. In the Gulf Coast, all five offshore tracts acquired in the western Louisiana offshore sale in 1970 were partially evaluated, along with several tracts in the Texas offshore. In the Mid-Continent area, we continued to explore the Anadarko basin of Oklahoma and Texas. Exploratory drilling was also conducted in the Rocky Mountain area. Preliminary work on our foreign properties was initiated, with seismic programs being carried out on our North Sea tracts and on the concession in Gabon.

Frank Davis, Jack Larsen, Boone Pickens, and Jim Upchurch review Mesa's drilling budget for 1972.

Production

Record production for the Company in natural gas, oil, and natural gas liquids resulted from increases in all of the Company's producing divisions. Calendar year 1971 marked the first full year of production of natural gas from our Hugoton field properties under a new twenty-year intrastate sales contract with Kansas Power & Light Company executed in May, 1970.

Agribusiness

Our Agro Division turned in an excellent performance in 1971. The average daily number of cattle in our feedyards during the year was 104,000, representing a 38 per cent increase over 1970. To secure a more stable and predictable earnings stream in future years, the Division's cattle backgrounding operation was expanded and diversified. The diversification will help provide our feedlot customers with a continuing supply of high quality feeder cattle. In order to satisfy our customers' growing demand for pen space, we have leased 50 per cent of a 25,000-head feedyard sixteen miles west of Amarillo.

Financial

On July 1, 1971, Mesa called for redemption all of its outstanding 6½% Subordinated Convertible Debentures due in 1983. On November 1, the Company called for redemption all of its outstanding $2.20 Cumulative Convertible Preferred Stock at a redemption price of $85 per share. The $2.20 Cumulative Convertible Senior Preferred Stock was not affected by this redemption. Substantially all of the debentures and the preferred shares were converted into common stock prior to the redemption dates.

Under an exploration agreement with Transcontinental Gas Pipe Line Corporation, Mesa received a five-year $5,000,000 interest-free loan. In return, Transco has a call on any gas production that is developed from certain dedicated properties in the Gulf Coast areas of Texas and Louisiana.

The Company's performance in 1971 was particularly gratifying, and we look forward to 1972 with optimism for continued growth.

Sincerely,

TB Pickens Jr.

T. B. Pickens, Jr.
President and Chairman of the Board

March 13, 1972

Exploration and Development

Mesa's exploration program continues to be directed toward selected areas where significant hydrocarbon reserves can be found. To facilitate this goal, we have expanded and upgraded our exploration staff and accelerated our acreage acquisition programs in both domestic and foreign areas. Dependable sources of energy can no longer satisfy the insatiable demand from world markets, and additional sources must be provided. We will continue to devote the major portion of our exploration expenditure to domestic prospects, but we will also place increasing emphasis on selected foreign ventures.

Gulf Coast Division

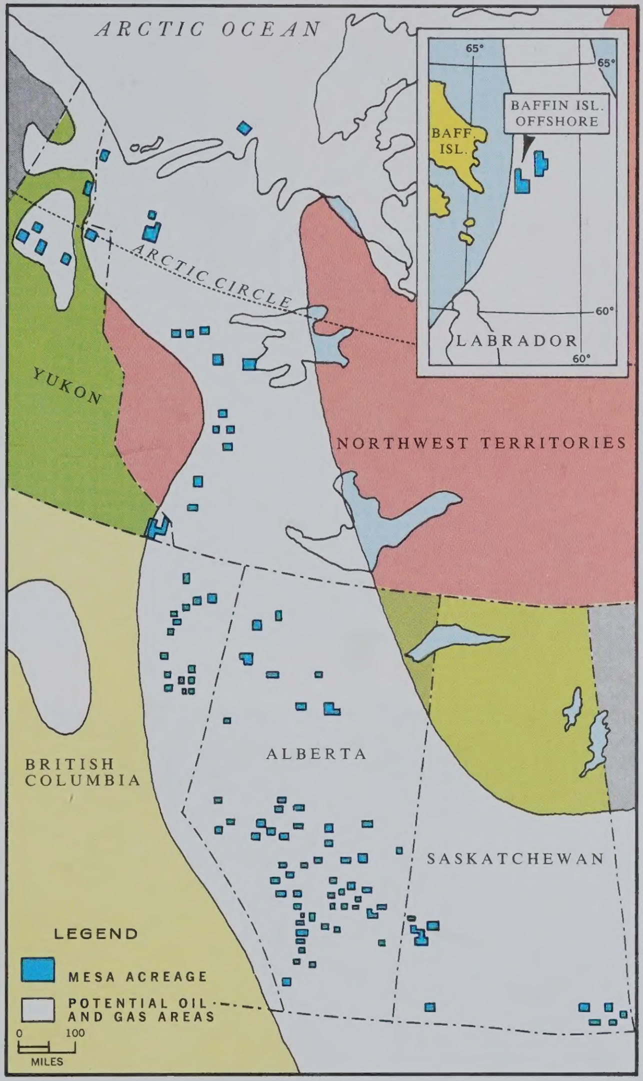
During 1971, Mesa participated in the exploratory drilling on five tracts acquired in the December, 1970 Federal lease sale for offshore Louisiana. The activity on each tract is summarized below:

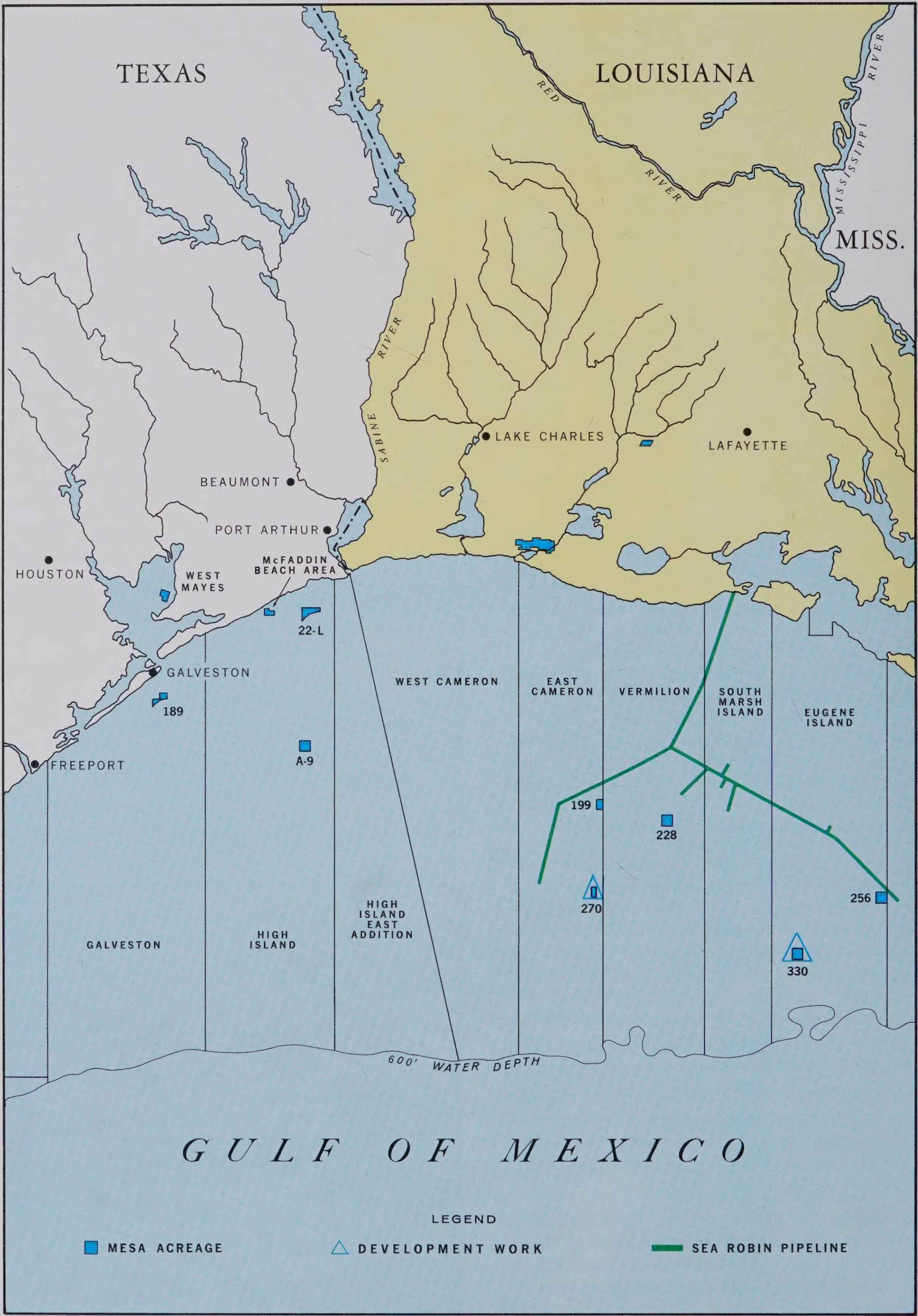
(1) *Block 330 Eugene Island (Mesa 5% interest)*—Based on the results of exploratory drilling, two 18-well drilling-producing platforms have been installed, and a third is scheduled for installation during the first quarter of 1972. To date, five development wells have been drilled from these two platforms. Initial sales of hydrocarbons will begin during the second quarter of 1973.

(2) *Block 270 East Cameron (Mesa 5% interest)*—Significant hydrocarbon reserves were also discovered on this tract. Two 18-well drilling-producing platforms have been installed, and ten development wells have been drilled to date. Initial gas production from this tract is scheduled to begin in the fourth quarter of 1972. Gas production from both Block 330 and Block 270 has been contracted to United Gas Pipe Line Company.

(3) *Block 228 Vermilion (Mesa 41.5% interest)*—Our initial test well on this tract was unsuccessful. It is anticipated that additional drilling will be done in 1972 to further evaluate this acreage.

(4) *Block 199 East Cameron (Mesa 28.89% interest)*—The initial test well on this tract was dry; however, additional exploratory work will be necessary to fully evaluate this acreage.




TEXAS
LOUISIANA
MISS.
RED RIVER
MISSISSIPPI RIVER
SABINE RIVER
LAKE CHARLES
LAFAYETTE
BEAUMONT
PORT ARTHUR
HOUSTON
WEST MAYES
McFADDIN BEACH AREA
22-L
GALVESTON
189
FREEPORT
A-9
WEST CAMERON
EAST CAMERON
VERMILION
SOUTH MARSH ISLAND
EUGENE ISLAND
199
228
270
256
330
GALVESTON
HIGH ISLAND
HIGH ISLAND EAST ADDITION
600' WATER DEPTH
GULF OF MEXICO
LEGEND
MESA ACREAGE
DEVELOPMENT WORK
SEA ROBIN PIPELINE

(5) *Block 256 Eugene Island (Mesa 16.77% interest)*—Four exploratory wells were drilled on this tract, without establishing sufficient reserves for a production platform. A fifth exploratory test is planned during 1972. In December, 1971, Mesa reduced its interest in this acreage from 30.77 to 16.77 per cent.

Mesa and Burmah Oil Development, Inc. were equal partners in the competitive bidding for offshore tracts at the Federal lease sale for eastern Louisiana in December, 1971. The proposed sale covered 78 blocks containing approximately 366,000 acres. The sale was held as scheduled, but due to legal action initiated by various environmental groups, all bids were returned. We are confident that as soon as certain questions pertaining to the environmental issues are resolved by the Interior Department, the sale will be rescheduled.

Early in 1971, Mesa announced the execution of an agreement with Transcontinental Gas Pipe Line Corporation with respect to six exploratory prospects in the Gulf Coast areas of Texas and Louisiana. Under the terms of this agreement, Mesa received a five-year $5,000,000 interest-free loan, and agreed to drill seven exploratory wells to test the six prospects. Transco, in turn, has a call on any gas production from the properties at the highest interstate price then approved by the Federal Power Commission. We have tested and condemned four of these prospects. Two prospects have been partially tested with inconclusive results, and additional drilling is scheduled for 1972.

Mesa made its first major entry into the Panhandle of Florida during 1971. Recent discoveries in the area by other companies confirm the presence of large hydrocarbon reserves. We have purchased over 300,000 gross acres in the Smackover trend of the Florida Panhandle and have participated in several hundred miles of seismic work. Our interest in this acreage averages approximately 35 per cent. We will accelerate our exploratory work in this area during 1972.

Central Division

The Central Division was formed by consolidating the Mid-Continent and Rocky Mountain Divisions into one office located in Amarillo, Texas.

Development work in the Granite Wash Field of Hemphill County, Texas continued during 1971. Gas sales from three wells in this field commenced in November. A fourth well, completed in February, 1972, tested 30 million

cubic feet of gas per day. Three additional development wells are scheduled during 1972. Mesa's average interest in this acreage is 71 per cent.

An exploratory test on our South Fargo prospect in Ellis County, Oklahoma was completed as a Morrow sand discovery. The well tested at the rate of 18 million cubic feet of gas per day. We own a 100 per cent interest in this well and in 5800 acres surrounding the drillsite. Development work will commence during the first quarter of 1972.

Mesa's budget for the Central Division will be increased considerably in 1972 due primarily to development drilling. Exploratory activities will also be expanded in this area due to recent gas price increases.

Canadian Division

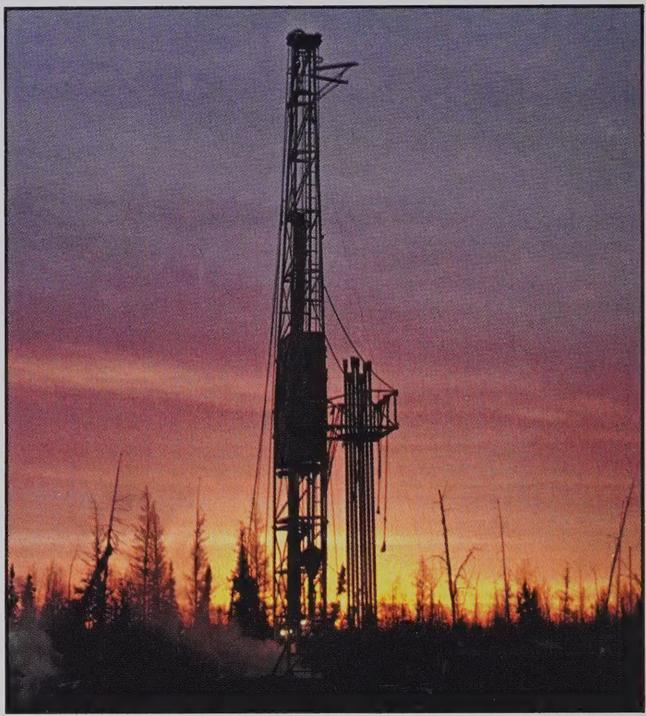
During 1971, approximately 25 per cent of our drilling budget was expended in Canada. We continue to become more active in western Canada because we believe it possesses two of the most important factors for successful oil industry participation: (1) a favorable discovery rate for economic reserves, and (2) relatively inexpensive prospective acreage.

Early in 1971, Mesa completed a significant Devonian reef gas discovery well south of the Clarke Lake gas field in British Columbia. This well flowed without stimulation at a rate of 30 million cubic feet of dry gas per day. Mesa's interest in the 1332 acre producing unit, after certain reversionary rights, will be 37.5 per cent. Gas sales from this well will commence in April, 1972 at a rate of approximately 10 million cubic feet per day. Two wells drilled south of the discovery failed to extend the field and were abandoned. We will be participating with a partner in the drilling of two additional wells during 1972 to evaluate a portion of our 12,000 acres in this area.

In northwestern Alberta, an exploratory test on our Hotchkiss prospect resulted in a shallow gas discovery. Additional exploratory work and drilling will be done on this acreage in 1972.

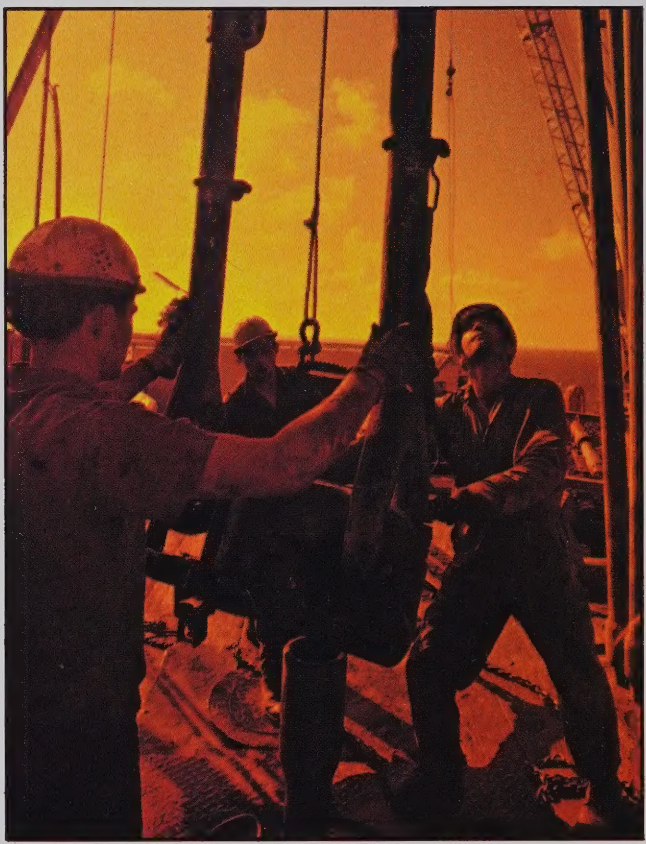
On the plains of eastern Alberta, we drilled three successful extension wells to our Lavoy gas unit which increased our recoverable reserves by 36 per cent. We own an additional 130,000 undeveloped acres in the area.

In the Hoosier area of southwestern Saskatchewan, step-out drilling to our existing produc-



An exploratory test commences in the foothills of Alberta.

Roughnecks make a trip while conducting exploratory drilling in the Louisiana offshore.



tion has proved several locations which will be developed in 1972.

International Operations

We continue to expand our exploration program into selected foreign countries. Our emphasis will be in geological provinces where major accumulations of hydrocarbons can be found, and where governments respect the sanctity of contracts.

The North Sea remains an area of increasing interest and activity. Mesa participated in combines which filed application on twenty-two tracts in the United Kingdom sector of the North Sea and on nine tracts in the Celtic Sea. We were unsuccessful in all of our Celtic Sea applications. No announcement has been made by the British Department of Trade and Industry on the North Sea filings, but we expect successful applicants for these tracts to be announced during the first half of 1972.

Initial seismic studies have been completed on Blocks 21/15 and 22/16 in the Median area of the United Kingdom sector. These tracts are part of a total of six tracts awarded to Mesa and several partners in 1970. Tract 21/15 is four miles south of British Petroleum's discovery well for the Forties Field, and Tract 22/16 is eight miles west of the Montrose Field discovered by Amoco. Geological and geophysical work on these tracts will continue during 1972.

In the second quarter of 1971, Mesa participated in the drilling of a test well onshore in southern England. The well was dry, and the project abandoned because additional geological and geophysical evaluation of the area offered very little encouragement.

In November, we announced an agreement under which Mesa can earn a 75 per cent interest in approximately 500,000 acres in the Tassi-Marin concession on the offshore continental shelf of Gabon in Central West Africa. Mesa can earn this interest by completing a seismic survey of the concession, and by exercising an option to commence an exploratory well prior to April 9, 1973. The concession is forty-five miles northwest of the Gamba-Ivinga Field and forty-two miles south of the 2500 barrel per day discovery announced by the Elf-Spafe Group late in 1971. We recently completed 480 miles of seismic work on the concession, and the data are currently being analyzed and interpreted.

Drilling rig on location in British Columbia.

Production

Mesa's average daily net production in 1971 was 201 million cubic feet of gas and 4750 barrels of oil and natural gas liquids, an increase over 1970 of 60 per cent and 61 per cent, respectively. This production represents new records for Mesa in both categories. Natural gas sales accounted for 80 per cent of total gas and oil revenues while oil and natural gas liquids represented 20 per cent.

Natural Gas

Mesa's net natural gas production in 1971 totaled 73,466,290 thousand cubic feet, compared with 45,846,289 thousand cubic feet in 1970.

Early in 1972, Mesa executed a twenty-one year Gas Purchase Contract with United Gas Pipe Line Company covering gas produced from Mesa's interest in the five offshore Louisiana tracts acquired at the Federal lease sale held in December, 1970. The contract provides for an initial base price of 35¢ per thousand cubic feet with an escalation of ½¢ per year, plus a BTU quality adjustment. The total initial price to be received by Mesa is expected to be 37½¢ per thousand cubic feet. The first production under this contract should commence from East Cameron Block 270 during the fourth quarter of 1972.

Gas sales commenced in November from three wells in our Granite Wash Field properties in Hemphill County, Texas. The initial price for this gas is 29¢ per thousand cubic feet. Deliveries from these wells average 1.5 million cubic feet of gas and 60 barrels of condensate per well per day. A fourth well completed in February, 1972, tested 30 million cubic feet of gas per day.

In Canada, gas sales increased 111 per cent over 1970. This was due primarily to the development of additional reserves and accelerated deliveries from our Lavoy gas unit in Alberta. Current gas deliveries from this unit average 11 million cubic feet of gas per day.

Oil & Natural Gas Liquids

Mesa's oil and natural gas liquids production in 1971 totaled 1,734,000 barrels, compared with 1,079,000 barrels in 1970.

Tug tows drilling-producing platform to Eugene Island Block 330.

One of two drilling-producing platforms installed on East Cameron Block 270 during 1971.

On our Hoosier Unit in Alberta, continued response from our water injection program is resulting in increased oil production. This secondary recovery program has arrested the normal production decline, and increased the daily rate by 40 per cent.

Agribusiness

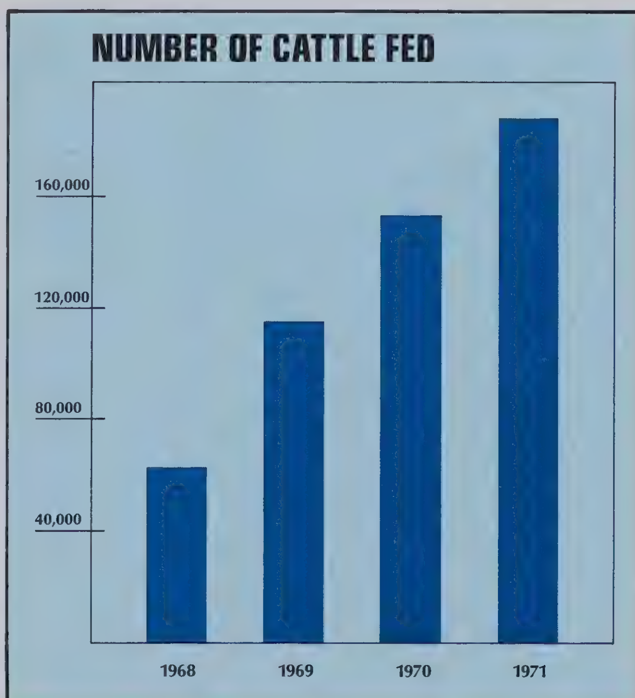
The year 1971 was an excellent year for our Agro Division. Record revenues and earnings resulted from substantially increased utilization of capacity in our feedlots. Several steps were taken in our Central Cattle Company operation to provide additional flexibility to our feedlots by insuring a continuous supply of feeder cattle of excellent quality and condition. Strong consumer demand for beef, along with encouraging developments in the national economy, indicate a favorable climate for the cattle feeding industry during the months ahead.

Feedlot Operations

Our feedlot operations set new records in revenues, net income, and in total number of cattle on feed. Average daily utilization of capacity in our lots increased 38 per cent to 104,000, compared to 75,000 for 1970. The number of cattle on feed reached an all-time high of 130,000 in December.

In order to satisfy the demand for additional pen space, we are participating on a 50 per cent basis in a 25,000-head feeding operation sixteen miles west of Amarillo. These facilities are being leased, and will provide our Agro Division greater flexibility in meeting the requirements of year-end cattle feeders without having to make capital expenditures to build new pens.

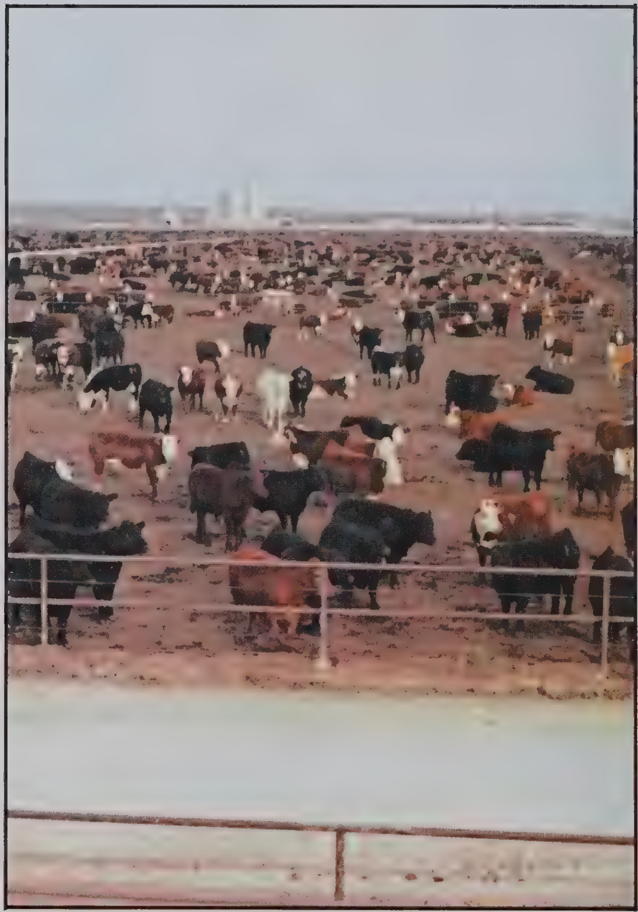
In June, the Agro Division sold its grain storage facilities at Tulia, Texas, thereby reducing the total capacity from 6.5 million to 2.5 million bushels. The remaining storage capacity is adequate to support our cattle feeding operation.



Cattle Operations

Central Cattle Company continued to provide our feedlot customers with high quality preconditioned feeder cattle. These cattle are purchased as light-weight calves and placed on one of Central's grazing leases for fattening to feeder weight of approximately 600 pounds. After reaching the desired weight, the cattle are either sold to our feedlot customers or fed for Central's own account. During 1971, the number of cattle fed by Central averaged approximately 28,000 head per day, or 27 per cent of the average daily number of cattle in our lots.

The procurement of desirable cattle has become more difficult for cattle feeders. Central Cattle Company maintains an inventory of high quality feeder cattle which are available to our customers. We have expanded our backgrounding operation by acquiring grazing leases in east Texas and Wyoming. These leases will provide additional pasture for our cattle, and, at the same time, introduce a degree of geographical diversification to the operation.

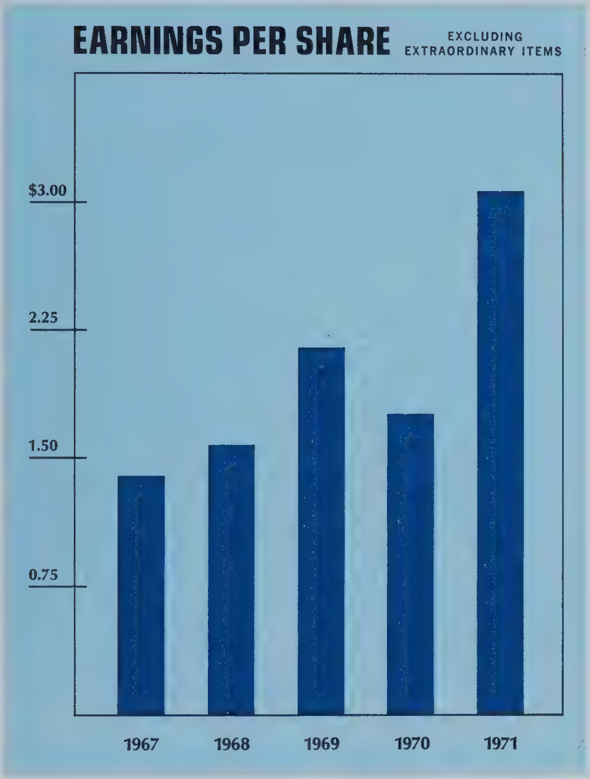


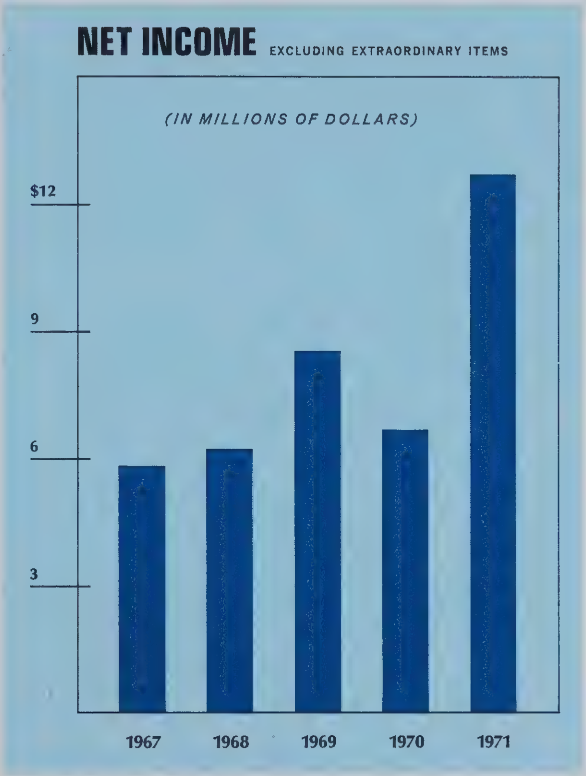
Texas' largest cattle feeding facility, Randall County Feedyard, has one-time capacity of 70,000 head.

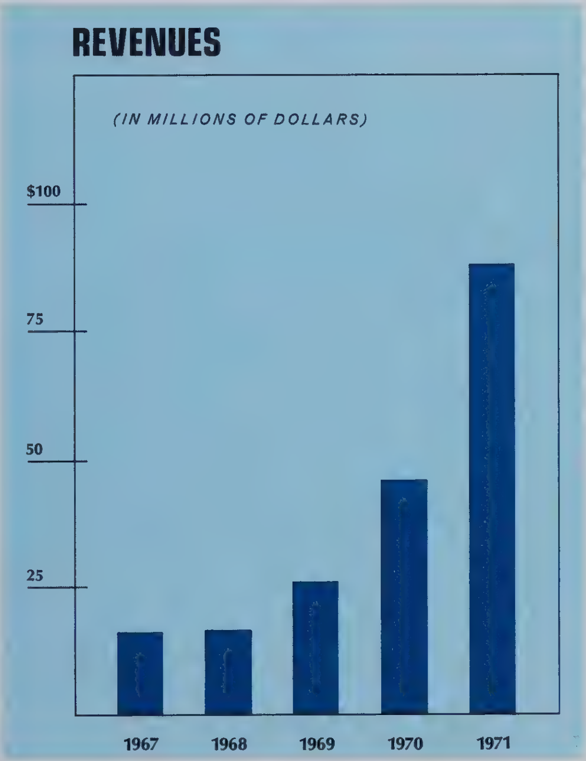
MESA
PETROLEUM CO.

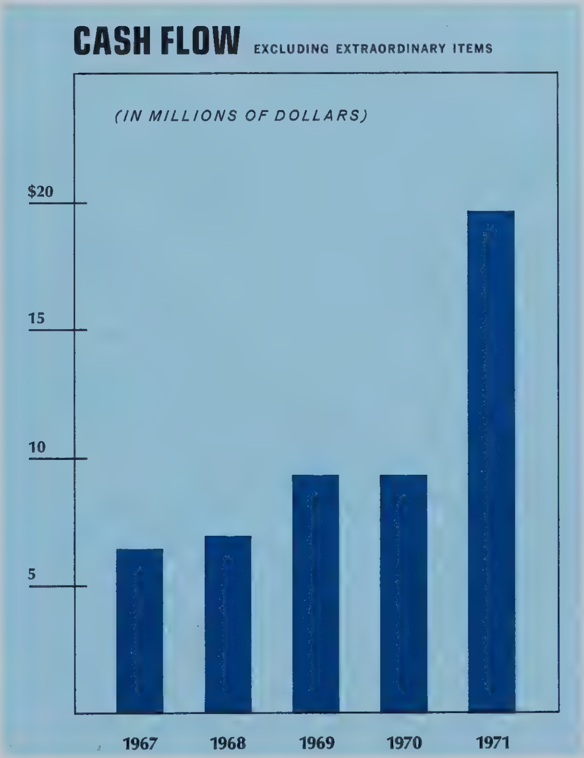
Tom Herrick and Jim Man, President and Vice-President of Mesa Agro.

Financial Review









Consolidated Balance Sheet

December 31, 1971 and 1970

Assets

	1971	1970
CURRENT ASSETS:		
Cash	$ 4,161,313	$ 1,007,701
Accounts and notes receivable	4,614,417	7,429,862
Estimated federal income tax refund (Note 3)	2,780,570	2,176,163
Inventories, at cost which is not in excess of market —		
Oil and gas leases held for resale within one year	—	233,740
Grain, feed, and cattle (Note 4)	12,544,334	5,581,851
Other	253,894	249,595
Prepaid expenses	144,280	222,566
Total current assets	$ 24,498,808	$16,901,478
INVESTMENTS, at cost	$ 2,243,733	$ 1,456,670
PROPERTY, PLANT AND EQUIPMENT, at cost (Notes 2 and 4):		
Plant, producing and nonproducing oil and gas leases, wells and equipment	$ 75,347,720	$58,047,029
Grain and cattle feeding facilities	6,041,431	6,573,698
Gilsonite mining properties and equipment	—	1,443,092
Automotive, office, and other properties	1,628,414	1,410,524
	$ 83,017,565	$67,474,343
Less — Accumulated depreciation, depletion, and amortization	13,436,642	10,285,926
	$ 69,580,923	$57,188,417
EXCESS OF COST OF COMPANIES ACQUIRED OVER EQUITY IN NET TANGIBLE ASSETS AT DATE OF ACQUISITION, not being amortized	$ 6,266,987	$ 6,266,987
DEFERRED CHARGES AND OTHER ASSETS:		
Issue expense on long-term debt, being amortized	$ 1,737,304	$ 973,135
Deposits and deferred charges	132,565	235,152
Cash surrender value of life insurance	230,748	194,100
	$ 2,100,617	$ 1,402,387
	$104,691,068	$83,215,939

(See accompanying notes to financial statements)

Liabilities

	1971	1970
CURRENT LIABILITIES:		
Current maturities on long-term debt	$ 2,588,355	$ 3,459,976
Short-term notes payable (Note 4)	7,526,845	3,095,000
Accounts payable and accrued liabilities	6,181,471	5,965,276
Accrued federal income taxes (Note 3)	2,187,419	1,275,535
Total current liabilities	$ 18,484,090	$13,795,787
LONG-TERM DEBT, net of current maturities (Note 4)	$ 33,517,189	$35,175,353
DEFERRED INCOME, advances on gas to be delivered in the future	$ 779,498	$ 1,155,245
DEFERRED FEDERAL INCOME TAXES	$ 1,951,374	$ 174,223
CONTINGENT LIABILITIES (Note 9)		
STOCKHOLDERS' INVESTMENT (Notes 5 and 8):		
Preferred stock, $1 par value, issuable in series, 5,000,000 shares authorized —		
$2.20 cumulative convertible senior preferred stock, issued 614,710 and 682,050 shares, respectively (liquidating preference of $46,103,250 at December 31, 1971)	$ 614,710	$ 682,050
$2.20 cumulative convertible preferred stock, issued 89,772 shares in 1970	—	89,772
Common stock, $1 par value, authorized 5,000,000 shares; issued 2,962,533 and 2,535,368 shares, respectively	2,962,533	2,535,368
Warrants to purchase 191,000 and 91,000 shares of common stock, respectively (Note 4)	1,591,500	591,500
Capital surplus	16,626,036	11,744,286
Reinvested earnings (Note 6)	28,164,138	17,272,355
	$ 49,958,917	$32,915,331
	$104,691,068	$83,215,939

(See accompanying notes to financial statements)

Consolidated Statement of Income

For the Years Ended December 31, 1971 and 1970

	1971	1970
OIL AND GAS OPERATIONS:		
Revenues —		
Natural gas and oil sales	$18,149,390	$11,195,207
Products extracted from natural gas	3,265,853	1,414,377
Proceeds from drilling arrangements	—	1,146,908
Other income	563,623	946,415
	$21,978,866	$14,702,907
Expenses —		
Operating expenses and royalties	$ 4,136,248	$ 2,776,274
Cost of drilling arrangements	—	749,931
Interest	1,860,248	2,560,535
Taxes, other than on income	826,475	572,759
Depreciation, depletion, and amortization (Note 2)	3,437,096	1,394,475
	$10,260,067	$ 8,053,974
Net operating income	$11,718,799	$ 6,648,933
CATTLE OPERATIONS:		
Feed, grain, and cattle sales	$66,114,758	$32,658,643
Expenses —		
Cost of feed, grain, and cattle	$58,535,386	$28,217,159
Operating expenses	2,109,529	2,124,194
Taxes, other than on income	124,145	62,103
Interest	1,261,353	967,057
Depreciation and amortization (Note 2)	568,929	537,784
	$62,599,342	$31,908,297
Net operating income	$ 3,515,416	$ 750,346
GENERAL AND ADMINISTRATIVE EXPENSES	$ 2,113,426	$ 1,688,924
INCOME BEFORE FEDERAL INCOME TAXES AND EXTRAORDINARY ITEMS	$13,120,789	$ 5,710,355
FEDERAL INCOME TAXES (Note 3):		
Current	(2,620,570)	(1,800,990)
Deferred	3,020,570	572,500
INCOME BEFORE EXTRAORDINARY ITEMS	$12,720,789	$ 6,938,845
EXTRAORDINARY ITEMS, net of applicable taxes	—	(254,312)
NET INCOME	$12,720,789	$ 6,684,533
EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE (Note 5):		
Income before extraordinary items	$3.05	$1.76
Extraordinary items	—	(.06)
Net income	$3.05	$1.70

(See accompanying notes to financial statements)

Consolidated Statements of Reinvested Earnings and Capital Surplus

For the Years Ended December 31, 1971 and 1970

	1971	1970
REINVESTED EARNINGS:		
Balance, beginning of year	$17,272,355	$12,662,068
Net income	12,720,789	6,684,533
Cash dividends —		
Common stock	(286,861)	(246,771)
Preferred stocks	(1,542,145)	(1,827,475)
Balance, end of year (Note 6)	$28,164,138	$17,272,355
CAPITAL SURPLUS:		
Balance, beginning of year	$11,744,286	$11,810,969
Stock options exercised (Note 8)	113,419	(13,866)
Conversion of preferred stocks	(137,613)	(218,191)
Conversion of convertible debentures	5,658,668	—
Expenses incurred in connection with merger in 1969, treated as a pooling of interests	—	(18,442)
Excess of market value over par value of common stock issued for companies acquired in 1969	—	183,816
Redemption of preferred stock	(752,724)	—
Balance, end of year	$16,626,036	$11,744,286

(See accompanying notes to financial statements)

Consolidated Statement of Changes in Financial Position

For the Years Ended December 31, 1971 and 1970

	1971	1970
SOURCE OF FUNDS:		
Net income	$12,720,789	$ 6,684,533
Depreciation, depletion, and amortization	4,006,025	1,932,259
Deferred federal income taxes	1,777,151	174,223
Funds provided from operations	$18,503,965	$ 8,791,015
Long-term borrowings	8,376,979	22,320,355
Common stock issued for conversion of debentures	5,804,084	—
Fair value of common stock issued for companies acquired in 1969	—	183,816
Fair value of warrants to purchase 100,000 and 42,000 shares of common stock, respectively, issued in connection with Series "A" and "C" notes	1,000,000	273,000
Proceeds from exercise of stock options	117,542	67,115
Advance on gas to be delivered in the future	(375,747)	1,155,245
Proceeds from sale of investment in Southland Royalty Company	—	15,273,680
Disposal of grain facilities and gilsonite properties	1,422,450	—
	$34,849,273	$48,064,226
USE OF FUNDS:		
Capital expenditures —		
Oil and gas properties	$17,515,876	$21,919,092
Feed, grain, and cattle facilities	113,637	172,532
Other properties	191,474	644,925
Retirement of long-term debt	10,906,764	19,508,816
Redemption of preferred stock	769,817	—
Cash dividends	1,829,006	2,074,246
Net additions to investments and other assets	1,485,293	510,295
	$32,811,867	$44,829,906
Increase (decrease) in working capital exclusive of current maturities —		
Cash and marketable securities	$ 3,153,612	$ (2,860,831)
Notes and accounts receivable	(2,211,038)	4,798,195
Inventories	6,733,042	(3,080,888)
Short-term notes payable	(4,431,845)	2,443,500
Accounts payable, accrued liabilities and federal income taxes	(1,128,079)	1,827,397
Other	(78,286)	106,947
	$ 2,037,406	$ 3,234,320
	$34,849,273	$48,064,226

(See accompanying notes to financial statements)

Notes to Consolidated Financial Statements

(1) PRINCIPLES OF CONSOLIDATION —

The consolidated financial statements include the accounts of the parent, Mesa Petroleum Co., and its wholly-owned subsidiaries. All significant intercompany transactions have been eliminated.

(2) ACCOUNTING POLICY RELATING TO OIL AND GAS PROPERTIES AND DEPRECIATION —

The Company follows the accounting policy of capitalizing, for financial purposes, all direct costs incurred in the acquisition, exploration, and development of gas and oil reserves, including nonproductive costs. Such capitalized costs are being amortized on a company-wide composite unit-of-production method over the aggregate productive life of all of its producing properties. Under this method of accounting, no gains or losses are recognized upon the sale or disposition of oil and gas properties, except in extraordinary transactions. Depreciation of grain and cattle feeding facilities and other equipment is provided on the straight-line method of depreciation.

(3) INCOME TAXES —

Due principally to the deduction for federal income tax purposes of intangible drilling and exploration costs, statutory depletion, and certain cattle inventory costs, the Company will report a loss for federal income tax purposes in 1971. This tax loss will result in a refund of approximately $2,780,000 of federal income taxes paid in 1968 by a predecessor company prior to acquisition by the Company. Any tax loss incurred in 1972 or thereafter would not result in any refund of prior taxes paid.

As of December 31, 1971, the Company has estimated unused operating loss carry-forwards of approximately $2,500,000 (expiring $780,000 in 1972, $1,120,000 in 1973, and $600,000 in 1976) which are available, subject to certain limitations, to reduce federal income taxes which may be payable in future periods.

Deferred taxes have been provided on accelerated depreciation of various facilities and equipment, certain cattle inventory costs, and certain leasehold costs deducted for tax purposes in excess of amounts deducted for financial reporting purposes. To the extent that the deferred taxes are attributable to current assets, the related reserve for deferred taxes is classified as a current liability. Deferred taxes applicable to intangible drilling and exploration costs, which are capitalized for

financial purposes as discussed in Note (2) and are deducted as incurred for income tax purposes, will be provided for at such time as these reductions reduce the future tax deductions applicable to the Company's present oil and gas properties below the present unamortized book cost of such properties. As a result of the deduction for tax purposes of intangible drilling and exploration costs, federal income taxes have been reduced and net income has been correspondingly increased by $5,100,000 and $3,400,000 in 1971 and 1970, respectively.

(4) SHORT-TERM NOTES PAYABLE AND LONG-TERM DEBT —

Short-term notes payable as of December 31, 1971 totaled $7,526,845 of 5% and 8% notes payable to banks which are secured by grain and cattle inventories.

Long-term debt and other obligations at December 31, 1971, and amounts due within one year are as follows:

	Long-Term	*Current*	*Total*
8% Secured Notes, Series "A", due 1985	$12,500,000	$ 500,000	$13,000,000
6½% Secured Note, Series "B", due 1975	4,125,000	1,375,000	5,500,000
9¼% Secured Notes, Series "C", due 1986	10,000,000	—	10,000,000
Non-Interest Bearing Unsecured Note, payable from production, if any, or beginning in 1974, with unpaid balance due in 1976	5,000,000	—	5,000,000
6½% Unsecured Promissory Note due in 1973 ..	900,000	—	900,000
8½% Unsecured Promissory Notes due in annual installments through January 10, 1973	476,000	500,000	976,000
Other	516,189	213,355	729,544
	$33,517,189	$2,588,355	$36,105,544

The 8% series "A" notes due 1985 were issued to three institutional lenders, along with ten-year warrants for the purchase of 91,000 shares of common stock of the Company at $45 per share. The Company has the option to purchase the warrants at $50 per warrant at any time prior to May 31, 1979. The series "B" note due 1975, which was issued to a bank, bears interest at the rate of 1% above the bank's prime rate. The 9¼% series "C" notes due 1986 were issued during 1971 to four institutional lenders, along with ten-year warrants for the purchase of 100,000 shares

of common stock of the Company at $33 per share. The Company has the option to purchase the warrants at $50 per warrant at any time prior to September 30, 1980. Under the mortgage indenture relating to the series "A", series "B", and series "C" notes, the Company has pledged its Hugoton field oil and gas properties. The mortgage agreement stipulates that the Company maintain unconsolidated current assets in excess of unconsolidated current liabilities, as defined, and the Company may incur additional indebtedness, not junior to the mortgage notes, only under certain conditions. The mortgage agreement allows the Company, subject to certain conditions and limitations, to secure under the mortgage additional borrowings, as long as the total borrowings under the mortgage do not exceed specified percentages (ranging from 50% to 22%) of the discounted value of estimated future net revenue of the pledged properties. Additional borrowings of approximately $45,000,000 are presently allowable under the mortgage agreement.

(5) COMMON AND PREFERRED STOCKS AND EARNINGS PER SHARE —

An analysis of the Company's common and preferred shares for the year ended December 31, 1971, is set forth below:

	Common	*$2.20 Senior Preferred*	*$2.20 Preferred*
Shares outstanding, beginning of year	2,535,368	682,050	89,772
Conversion of $2.20 senior preferred stock	126,221	(67,340)	—
Conversion of $2.20 preferred stock	151,404	—	(80,811)
Redemption of $2.20 preferred stock	—	—	(8,961)
Conversion of convertible debentures	145,416	—	—
Stock options exercised	4,124	—	—
Shares outstanding, end of year	2,962,533	614,710	—

Each share of the $2.20 cumulative convertible senior preferred stock is entitled to one vote per share and preferential annual cash dividends of $2.20 per share, is convertible into 1.875 shares of common stock of the Company until March 1, 1974, and 1.6 shares thereafter, is entitled to preferential payment of $75 per share on liquidation, and is redeemable at $85 per share until March 1, 1974, and $75 per share thereafter.

Earnings per share have been computed based upon the weighted average number of common

shares outstanding during each period and assuming conversion of all preferred stocks, and exercise of stock options and warrants which have a dilutive effect.

(6) RESTRICTIONS ON PAYMENT OF DIVIDENDS —

The Company is restricted as to the payment of cash dividends under its mortgage agreement. At December 31, 1971, approximately $15,500,000 of reinvested earnings was not restricted as to the payment of dividends.

(7) FEDERAL POWER COMMISSION PROCEEDING —

In a proceeding before the Federal Power Commission, the Company requested authorization for the abandonment of sales of natural gas by Hugoton to Panhandle Eastern Pipe Line Company in the years 1961 through 1965. The Commission denied the application and ordered Hugoton to make refunds for the years 1961 and following, plus interest thereon. The Commission agreed to a final settlement in December, 1971, whereby the Company refunded to Panhandle $930,523, including interest. The refund, net of federal income tax benefit of $491,316, was charged to reserves provided in prior years.

(8) STOCK OPTIONS —

The Company's 1965 and 1969 qualified stock option plans and 1970 non-qualified stock option plan authorize the granting of options for 336,300 shares of common stock. As of December 31, 1971, options for 110,150 shares were outstanding at prices ranging from $30.12 to $53.57 per share. During the year ended December 31, 1971, options for 4,124 shares were exercised at prices ranging from $12.40 to $38.69.

(9) CONTINGENT LIABILITIES —

The Company has entered into profit sharing arrangements with certain feedyard customers whereby the Company shares in 50 per cent of the net profits realized by these customers on cattle sales, and the Company guarantees these customers against losses in excess of certain amounts. At December 31, 1971, the Company was contingently liable as guarantor of approximately $7,000,000 of the debts of these feedyard customers and others.

Auditors' Report

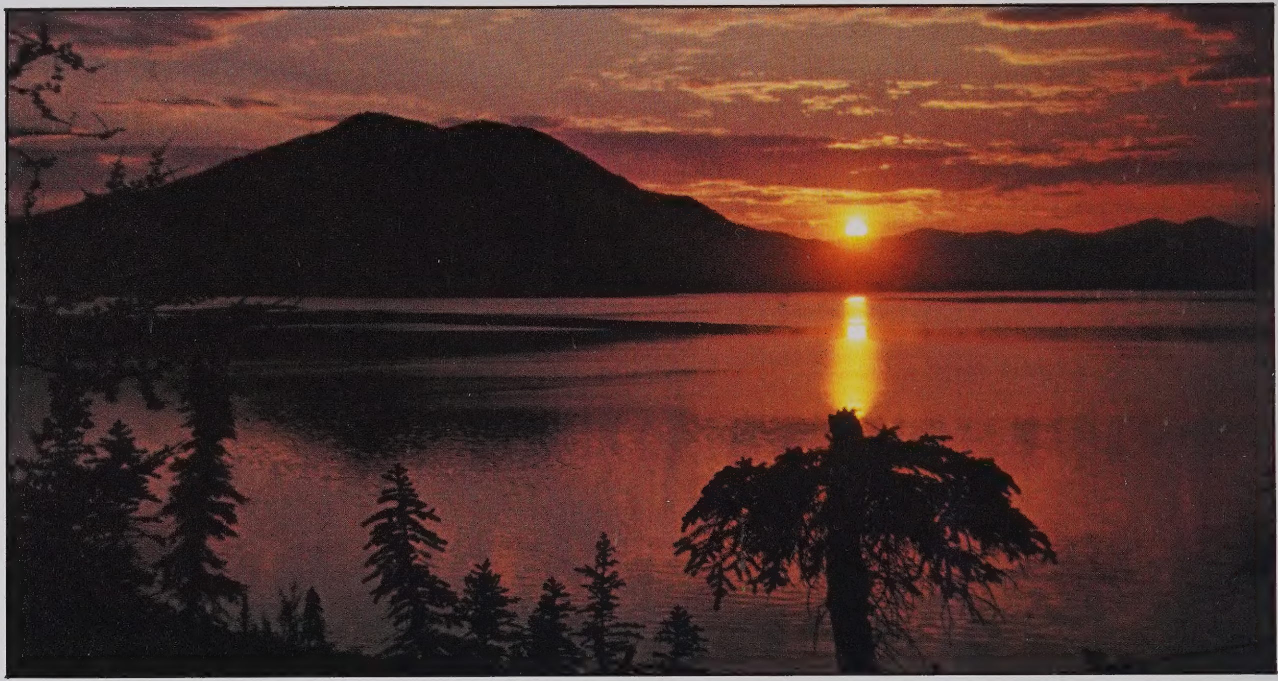
To the Stockholders and Board of Directors,
MESA PETROLEUM CO.:

We have examined the consolidated balance sheet of Mesa Petroleum Co. (a Delaware corporation) and subsidiaries as of December 31, 1971 and 1970, and the related consolidated statements of income, reinvested earnings, capital surplus, and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Mesa Petroleum Co. and subsidiaries as of December 31, 1971 and 1970, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

ARTHUR ANDERSEN & CO.

Houston, Texas
February 25, 1972



DIRECTORS

Lester A. Anderson
John D. Kirkland*
Wales H. Madden, Jr.*
Michael A. Nicolais
T. B. Pickens, Jr.*
Richard S. Smith
Robert L. Stillwell

* Member of Executive Committee

TRANSFER AGENTS

Common Stock
The Chase Manhattan Bank (National Association)
The First National Bank of Amarillo

Preferred Stock
Irving Trust Company

REGISTRARS

Common Stock
Irving Trust Company
First City National Bank of Houston

Preferred Stock
The Chase Manhattan Bank (National Association)

AUDITORS

Arthur Andersen & Co.
Houston, Texas

COUNSEL

Selecman and Madden
Amarillo, Texas

Baker & Botts
Houston, Texas

OFFICERS

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Jack K. Larsen, *Vice President - Exploration*

John E. Stobart, *Vice President - International Operations*

James O. Upchurch, *Vice President - Engineering*

John F. Boros, *Secretary and Treasurer*

OFFICES

Executive Offices and Central Division
Vaughn Building
320 S. Polk St.
P. O. Box 2009
Amarillo, Texas 79105

Gulf Coast Division
First City East Building
1111 Fannin St.
Houston, Texas 77002

Canadian Division
Bradie Building
630 6th Avenue S.W.
Calgary, Alberta